Supreme Court, U. S.
FILED
SEP 2 - 1980
MICHAEL RODAK, JR., CLERK

No. 80-338

IN THE

Supreme Court of the United States

October Term, 1980.

HCSC-LAUNDRY,

Petitioner,

v.

THE UNITED STATES OF AMERICA,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

NORMAN A. PEIL, JR.,
PEIL & EGAN, P. C.,
Alpha Building,
Easton, PA
Counsel for Petitioners.

International Printing Co., 711 So. 50th St., Phila., Pa. 19143 — Tel. (215) 727-8711

QUESTION PRESENTED FOR REVIEW.

Did the Congress of the United States, in enacting section 501(e) of the Internal Revenue Code, which specifically permits joint hospital facilities performing specified services to be treated as tax-exempt charitable organizations under section 501(c)(3) of the Code, intend to preclude joint hospital facilities performing services not specifically included in section 501(e) from qualifying as tax-exempt charitable organizations under section 501 (c)(3)?

TABLE OF CONTENTS.

	Page
QUESTION PRESENTED FOR REVIEW	i
OPINIONS BELOW	1
JURISDICTION	2
STATUTES AND REGULATIONS INVOLVED	2
STATEMENT OF THE CASE	5
ARGUMENT	7
CONCLUSION	13
APENDIX:	
Opinion of the United States Court of Appeals for the Third Circuit by Sloviter, Circuit Judge	A1
Judgment of the United States Court of Appeals for the Third Circuit	A20
Opinion and Order of the United States District Court for the Eastern District of Pennsylvania, E. Mac Troutman, Judge	A22

TABLE OF CITATIONS.

Cases: Page

Associated Hospital Services, Inc. v. Commissioner, 74 T. C. — (No. 17) (1980) 8

Chart, Inc. v. United States, 45 AFTR 2d 80-555 (1980) on appeal to the Court of Appeals for the District of Columbia 10

Community Hospital Services, Inc. v. United States, 43 AFTR 2d 79-934 (E. D. Mich., 1979) on appeal to the Sixth Circuit (No. 79-1286) and the District Court for the Eastern District of Pennsylvania in the instant case, 473 F. Supp. 250 ..... 7, 8

Hospital Central Services Association v. United States, 40 AFTR 2d 77-5646 (W. D. Wash., 1977) reversed — F. 2d — No. 77-3701) (C. A. 9, July 21, 1980) 7

Metropolitan Detroit Area Hospital Services, Inc. v. United States, 445 F. Supp. 857 (E. D. Mich., 1978) on appeal to the Court of Appeals for the Sixth Circuit (No. 79-1205 and 78-1218) 7, 10

Northern California Central Services, Inc. v. United States, 591 F. 2d 620 (1979) 8

United Hospital Services, Inc. v. United States, 384 F. Supp. 776 (S. D. Ind., 1974) 7

Va. Professional Standard Review Foundation v. Blumenthal, (D. C. D. C. 446 F. Supp. 1164 (1979)) 12

Statutes and Regulations:

Internal Revenue Code of 1954 (Title 26 United States Code):

Section 501(a) 3, 4, 5

Section 501(c)(3) .....i, 2, 3, 4, 5, 7, 8

Section 501(e) .....i, 3, 7, 8

Judicial Code (Title 28 United States Code):

Section 1254(1) 2

Section 1346 6

Regulations 1.501(c)(3)-1(d)(2) 4

IN THE

Supreme Court of the United States

OCTOBER TERM, 1980.

No. .

HCSC-LAUNDRY,

Petitioner,

v.

THE UNITED STATES OF AMERICA,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

TO THE HONORABLE CHIEF JUSTICE AND ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

HCSC-Laundry, a Pennsylvania non-profit corporation, by its attorneys, respectfully prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Third Circuit entered June 6, 1980.

OPINIONS BELOW.

The Memorandum and Order of the District Court for the Eastern District of Pennsylvania dated July 10, 1979 is printed at pages A22 to A32, *infra*, and reported at

473 F. Supp. 250. The opinion of the United States Court of Appeals for the Third Circuit reversing the District Court filed June 6, 1980 (No. 79-2286), is printed at pages A1 to A19, *infra*, and reported at — F. 2d —. The judgment of the Court of Appeals entered June 6, 1980 is printed at page A20, *infra*, and not officially reported.

JURISDICTION.

The judgment sought to be reviewed is dated June 6, 1980 which is also the date of its entry. The jurisdiction of this Court is invoked under Section 1254(1) of the Judicial Code, Title 28 U. S. C. 1254(1).

STATUTES AND REGULATIONS INVOLVED.

Internal Revenue Code of 1954, Title 26 United States Code, Section 501 the pertinent portions of which are as follows:

> § 501. Exemption from tax on corporations, certain trusts, etc.
>
> (a) Exemption from taxation—An organization described in subsection (c) or (d) or section 401(a) shall be exempt from taxation under this subtitle unless such exemption is denied under section 502 or 503.
>
> * * *
>
> (c) List of exempt organizations—The following organizations are referred to in subsection (a):
>
> * * *
>
> (3) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing

for public safety, literary, or education purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

* * *

(e) Cooperative hospital, service organizations —For purposes of this title, an organization shall be treated as an organization organized and operated exclusively for charitable purposes, if—

(1) such organization is organized and operated solely—

(A) to perform, on a centralized basis, one or more of the following services which, if performed on its own behalf by a hospital which is an organization described in subsection (c)(3) and exempt from taxation under subsection (a), would constitute activities in exercising or performing the purpose or function constituting the basis for its exemption: data processing, purchasing, warehousing, billing and collection, food, clinical, industrial engineering, laboratory, printing, communications, record center, and personnel (including selection, testing, training, and education of personnel) services; and

(B) to perform such services solely for two or more hospitals each of which is—

(i) an organization described in subsection (c)(3) which is exempt from taxation under subsection (a),

(ii) a constituent part of an organization described in subsection (c)(3) which is exempt from taxation under subsection (a) and which, if organized and operated as a separate entity, would constitute an organization described in subsection (c)(3), or

(iii) owned and operated by the United States, a State, the District of Columbia, or a possession of the United States, or a political subdivision or an agency or instrumentality of any of the foregoing;

(2) such organization is organized and operated on a cooperative basis and allocates or pays, within 8½ months after the close of its taxable year, all net earnings to patrons on the basis of services performed for them; and

(3) if such organization has capital stock, all of such stock outstanding is owned by its patrons.

For purposes of this title, any organization which, by reason of the preceding sentence, is an organization described in subsection (c)(3) and exempt from taxation under subsection (a), shall be treated as a hospital and as an organization referred to in section 170(b)(1)(A)(iii).

Regulations Section 1.501(c)(3)-1(d)(2).

(a) *Charitable defined.* The term "charitable" is used in section 501(c)(3) in its generally accepted legal sense and is, therefore, not to be construed as limited by the separate enumeration in section 501(c)(3) of other tax-exempt purposes which may fall within the broad outlines of "charity" as developed by judicial decisions.

STATEMENT OF THE CASE.

The facts in the case were fully stipulated and are not in issue. Petitioner, HCSC-Laundry, was incorporated in 1967 under the Pennsylvania Non-Profit Corporation Law to provide laundry and linen service to fifteen non-profit hospitals and a small ambulance service all located in Eastern Pennsylvania. All of the organizations served have received federal income tax exemptions under Section 501(c)(3) of the Internal Revenue Code. Each participating hospital pays dues based upon its bed capacity. Petitioner's purpose, as set forth in its Articles of Incorporation, is to (a) operate and maintain a hospital laundry and linen supply program for those public hospitals and non-profit hospitals or related health facilities organized and operated exclusively for religious, charitable, scientific, or educational purposes that contract with it, (b) to cooperate with the Greater Lehigh Valley Hospital and Health Planning Council in carrying out the foregoing purposes, and (c) to accomplish the foregoing purposes in a manner consistent with the provisions of Section 501(c)(3) of the Internal Revenue Code of 1954. Under its by-laws, none of its profits may be distributed other than to hospital members. No part of its earnings may inure or have inured to the benefit of any individual or profit-making corporation. Petitioner's facilities provide sanitary and quality standards not always available from commercial laundries.

Petitioner was formed following an investigation into the various ways in which laundry service could be provided to area hospitals upon the recommendation of the Lehigh Valley Health Planning Council, an agency under the Hill-Burton Act, which had received numerous requests from area hospitals to approve funds to modernize their respective in-plant laundry facilities. The Council

investigated and considered alternate sources of laundry sources available to area hospitals. Among the options the council considered were individual hospital laundries, commercial off-premises facilities, joint facilities with a single hospital laundry providing services to one or more hospitals beside itself, and shared non-profit, off-premises laundries which service several non-profit hospitals. A joint service was rejected because no hospital in the area had sufficient laundry facilities to serve more than itself. A large commercial laundry contacted was not interested in handling the full volume of laundry business of all the hospitals involved, and most of the other available commercial laundries were considered incapable of handling the heavy volume. The council concluded that a shared non-profit-off-premises laundry would best accommodate the requirements of the member hospitals both from the viewpoint of quality of service and economies of scale.

In addition to nominal dues, Petitioner's only other income is received from charges to its members for laundry and linen service furnished based upon budgeted cost plus a charge of 1½¢ per pound for funding equipment replacement and acquisition. The "profit" which the United States, through the Internal Revenue Service, seeks to tax is represented by the difference between the debt amortization included in the cost figure and the depreciation allowable on the assets acquired with such debt plus the 1½¢ per pound charge.

Jurisdiction over this matter is conferred upon the United States District Court by Title 28, United States Code, section 1346.

ARGUMENT.

The decision of the Court of Appeals for the Third Circuit, to which this petition is addressed, is contrary to the holding of every other federal court on the question involved save only the United States Tax Court. (Subsequent to the Third Circuit's decision, its position was followed by the Ninth Circuit in a per curiam decision rendered July 21, 1980 and cited below.) The Tax Court decision was based on the argument that organizations of the type which Petitioner represents are feeder organizations under Section 502 of the Internal Revenue Code, a position which has been uniformly rejected by the other federal courts that have had occasion to consider the question. Indeed, in the instant case, this argument was made by the government in the District Court but was abandoned on appeal and the Third Circuit decided the question solely on the basis of whether Congress, by enacting Section 501(e) of the Internal Revenue Code, (relating to specified cooperative hospital services) and that section's legislative history, automatically precluded an organization which provides cooperative hospital services not specified in Section 501(e), such as Petitioner, from qualifying as a tax-exempt organization under Section 501(c)(3).

The government's legislative history argument was made unsuccessfully to five District Courts, namely, *United Hospital Services, Inc. v. United States,* 384 F. Supp. 776 (S. D. Ind., 1974), *Hospital Central Services Association v. United States,* 40 AFTR 2d 77-5646 (W. D. Wash., 1977) reversed — F. 2d — (No. 77-3701) (C. A. 9, July 21, 1980), *Metropolitan Detroit Area Hospital Services, Inc. v. United States,* 445 F. Supp. 857 (E. D. Mich., 1978) on appeal to the Court of Appeals for the Sixth Circuit (No. 79-1205 and 78-1218), *Community*

Hospital Services, Inc. v. United States, 43 AFTR 2d 79-934 (E. D. Mich., 1979) on appeal to the Court of Appeals for the Sixth Circuit (No. 79-1286) and the District Court for the Eastern District of Pennsylvania in the instant case, 473 F. Supp. 250. Counsel has also been informed that the decision of the United States Tax Court in *Associated Hospital Services, Inc. v. Commissioner,* 74 T. C. — (No. 17), (1980) is being appealed to the Court of Appeals for the Fifth Circuit. Aligned with this array of consistent decisions by the United States District Courts is a decision in December, 1979 by the United States Court of Claims, a court of co-equal rank with that of the Third Circuit, *Northern California Central Services, Inc. v. United States,* 591 F. 2d 620 (1979).

At oral argument in the Third Circuit, government counsel agreed that the facts of the instant case are for all relevant purposes the same as those of the predecessor cases cited above.

The narrow issue to be resolved is whether the legislative history underlying the enactment of Section 501(e) indicated an intention by Congress to preclude a joint hospital service organization not enumerated in that section from qualifying for federal income tax exemption under Section 501(c)(3). That the legislative history does not clearly deal with the issue is obvious from the sharply divergent views regarding the conclusion to be drawn from that history reached in the decisions cited above and can be summarized by the following extracts from the decisions of the United States Court of Claims and the Third Circuit.

The Court of Claims in *Northern California Central Services, Inc., supra,* summarized its conclusion on this issue as follows: (pps. 623 and 624)

> "Defendant's brief details legislative history indicating that Congress had long considered granting ex-

emptions to shared laundry services under § 501(e) and eventually decided against such an action. This, counsel for the government concludes, demonstrates that Congress deliberately foreclosed opportunities for shared laundry services to obtain an exemption under any other provision of § 501, including § 501 (c)(3). * * * It is, we suppose, arguable that Congress preempted the subject of hospital laundries in passing § 501(e), and by not mentioning them with other hospital services it did mention, carved them out of § 501(c)(3). Our consideration of the legislative history of § 501(e) does not lead us to this sweeping conclusion. Section 501(e) provides an exemption for some cooperative organizations which adhere to the requirements stated therein. We agree with plaintiff that the intent of Congress in passing § 501(e) was to broaden the class of organizations entitled to an exemption as a 'charitable organization' not to narrow it, and that, as to laundry services, it left the law as it was.

"In considering § 501(e)'s history, it is necessary to examine not only what Congress did do in 1968 when it added that provision, but what it did not do.***"

In direct contrast with this analysis and conclusion is the statement of the Court of Appeals for the Third Circuit in the instant case at page 17 of the slip opinion as follows:

"***As noted in our prior discussion, we believe the legislative history to show a contrary legislative intent than that found by the Court of Claims. We believe that it demonstrates that Congress recognized that hospital service organizations were not heretofore considered within Section 501(c), or that their

> inclusion within that section was questionable. In order to clarify its position, Congress enacted Section 501(e) to specify that certain types of hospital service organizations shall be considered as charitable organizations. If they had already been within Section 501(c), the enactment of Section 501(e) would have been a totally superfluous undertaking by Congress, an anomalous result which we cannot attribute to it. [footnote omitted]"

As to this argument, see contra the holding of the United States District Court for the District of Columbia in *Chart, Inc. v. United States,* 45 AFTR 2d 80-555 (1980) on appeal to the Court of Appeals for the District of Columbia.

In summary, as the matter now stands, every district court which has considered the matter has held in favor of the Petitioner's position, the United States Tax Court with four dissents and on a completely different legal theory not espoused by the government in this case has held for the government, the Court of Claims has held for the Petitioner's position and, a court of co-equal rank, the Court of Appeals for the Third Circuit, recently supported by the Court of Appeals for the Ninth Circuit, has held for the government. Appeals in similar cases are pending in the Fifth and Sixth Circuits and the Court of Appeals for the District of Columbia. (It is counsel's understanding that the *Metropolitan Detroit Area* case *supra,* has been argued to the Sixth Circuit but not decided.) Clearly this sharp split between the various federal courts including those of co-equal rank renders impossible the uniform administration of the tax laws throughout the country. Thus, the situation presents a classic basis for review of the Third Circuit's decision by this Court under its Rule 17(a).

Furthermore, Petitioner believes that there is an additional and compelling reason why this Court should accept its Petition for Certiorari. This case involves more than merely the tax-exempt status of an isolated taxpayer. Rather, it represents a challenge to the tax status of numerous similarly situated cooperative hospital service laundries throughout the United States. The principal motivation for organization of such joint laundries was the control over sanitary standards necessary to efficient hospital operations and the attempt to contain this aspect of hospital costs through the economies of scale. This approach is in recognition of the conclusions reached in numerous studies by various Health Planning Councils, agencies created under the Hill-Burton Act, 42 U. S. C. § 291. A survey of the 36 known hospital joint service laundries such as Petitioner from which 26 replies were received indicates that there are well over 175 hospitals throughout the United States served by such hospital joint service laundries. Furthermore, the amount of the taxes involved, and therefore the ultimate effect on hospital costs, is not insignificant. The same survey indicates that there is presently pending in the courts or subject to future determination through the most recently-ended fiscal years of the organization's potential federal income taxes of over $2,700,000 which, of course, will continue to accrue year after year if the law is as interpreted by the Third Circuit. These taxes will, of necessity, be passed on to the member hospitals in the form of higher laundry costs and, inevitably, to the patient in higher hospital charges.

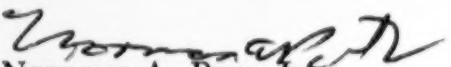
Ironically, the result reached by the Third Circuit is diametrically opposed to the ongoing efforts of the federal government to contain and control hospital costs. Thus, in an attempt to limit the amount of Medicare reimbursement to hospitals for legitimate expenses, the former De-

partment of Health, Education and Welfare mandated that hospitals act as "prudent and cost-conscious buyers" seeking to minimize the costs of goods and services. Provider Reimbursement Manual (P. R. M.) HIM-10 Part L § 2103. (The Manual is based upon 20 C. F. R. 405.451(c)(2)(ii) and 40 Fed. Reg. 51,474 and 51,975 (1975)).

The Department of Health, Education and Welfare's encouragement of shared service arrangements to contain costs is consistent with the intent of Congress as expressed in 42 U. S. C. § 300k-2. In that section Congress found that shared services deserved "priority consideration in the formulation of national health planning goals and in the development and operation of Federal State and Health area planning and resources development programs." It identified as such a goal: the development of multi-institutional arrangements for the sharing of support services necessary to all health service institutions. Shared laundry services, such as those involved in this case, are an essential part of the cost containment effort favored by Congress. See, *Va. Professional Standard Review Foundation v. Blumenthal,* (D. C. D. C. 446 F. Supp. 1164 (1979)).

CONCLUSION.

It is respectfully submitted that this Court should grant certiorari to resolve the conflict between the decision of the Court of Appeals for the Third Circuit and that of the Court of Claims in the interests of the uniform administration of the tax laws throughout the country and further in the interests of determining the federal income tax status of shared service laundry organizations in light of the Department of Health, Education and Welfare's emphasis on shared hospital service facilities for cost containment purposes.



NORMAN A. PEIL, JR.,
PEIL & EGAN, P. C.,
Counsel for Petitioner.

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 79-2286

HCSC-LAUNDRY

v.

UNITED STATES OF AMERICA,
Appellant

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA
(D. C. Civil No. 78-1409)

Argued February 21, 1980
Before: ROSENN, SLOVITER, *Circuit Judges* and
LAYTON, *District Judge* *
(Opinion filed June 6, 1980)

M. CARR FERGUSON,
Assistant Attorney General
GILBERT E. ANDREWS
LEONARD J. HENZKE, JR.
DAVID ENGLISH CARMACK (Argued)
Tax Division
Department of Justice
Washington, D. C. 20530

Of Counsel:
PETER F. VAIRA
United States Attorney
Attorneys for Appellant

* Honorable Caleb R. Layton, III, United States District Judge for the District of Delaware, sitting by designation.

NORMAN A. PEIL, JR. (Argued)
MICHAEL J. EGAN
PEIL & EGAN, P. C.
Alpha Building
P. O. Box 351
Easton, Pa. 18042
Attorneys for Appellee

STEPHEN JOHN FELLMAN
HENRY ASHTON HART
LOOMIS, OWEN, FELLMAN & HOWE
2020 K Street, N. W., Suite 800
Washington, D. C. 20006

Attorneys for Amicus Curiae
Textile Rental Services
Association of America

THOMAS C. BRICKLE
1050 17th Street, N. W., Suite 500
Washington, D. C. 20036

Attorneys for Amicus Curiae
International Fabricare
Institute

OPINION OF THE COURT

SLOVITER, *Circuit Judge.*

I.

On this appeal by the IRS from summary judgment entered against it, we must decide whether Congress, in enacting section 501(e) of the Internal Revenue Code, which specifically permits joint hospital facilities performing specified services to be treated as tax exempt charitable organizations under section 501(c)(3) of the

Code, intended that joint hospital facilities performing services not specifically included in section 501(e) could nevertheless be treated as tax exempt charitable organizations under section 501(c)(3).

II.

Plaintiff HCSC-Laundry, a non-profit corporation with its principal office in Allentown, Pennsylvania, was incorporated under the Pennsylvania Nonprofit Corporation Law on January 3, 1967.[1] It provides laundry and linen service to fifteen non-profit hospitals located in the Greater Lehigh Valley, Reading, Scranton, and suburban Philadelphia, Pennsylvania, and to the Cetronia Ambulance Corps, which serves a village adjacent to Allentown, Pennsylvania. All the hospitals and the ambulance corps have received federal income tax exemptions under section 501(c)(3) of the Internal Revenue Code.

The formation of HCSC-Laundry followed an investigation into the various possible ways in which laundry service could be provided to the area hospitals. In early 1966 the Lehigh Valley and Health Planning Council,

---

1. Its purpose, as set forth in its Articles of Incorporation, as amended May 29, 1970, is:

A. To operate and maintain a hospital laundry and linen supply program for those public hospitals and non-profit hospitals or related health facilities organized and operated exclusively for religious, charitable, scientific, or educational purposes that contract with this corporation.

B. To cooperate with the Greater Lehigh Valley Hospital and Health Planning Council in carrying out the foregoing purposes.

C. To accomplish the foregoing purposes in a manner consistent with the provisions of Section 501(c)(3) of the Internal Revenue Code of 1954.

an agency under the Hill-Burton Act,[2] received requests from some of the area hospitals to approve funds requested to modernize their hospitals' in-plant laundries. The Council investigated and considered alternate sources of laundry services available to area hospitals. Among the options the Council considered were individual hospital laundries, commercial off-premises facilities, joint facilities with a single hospital laundry providing services to one or more hospitals beside itself, and shared nonprofit, off-premises laundries which service several nonprofit hospitals. A joint service was rejected because no hospital in the area had sufficient laundry facilities to

2. The Hill-Burton Act, a funding statute, was enacted, *inter alia*, to assist the states in carrying out programs for construction and modernization of "such public or other nonprofit community hospitals and other medical facilities as may be necessary, in conjunction with existing facilities, to furnish adequate hospital, clinic or similar services," 42 U. S. C. § 291. In order to participate in the program, states have to submit comprehensive plans designating "a single State agency as the sole agency for the administration of the plan, or designat[ing] such agency as the sole agency for supervising the administration of the plan," 42 U. S. C. § 291d(a)(1), as well as indicating the existing facilities, the needs within the state and a construction and modernization program which will meet those needs. 42 U. S. C. § 291d(a). A 1964 amendment emphasized the need for comprehensive planning in metropolitan and local areas. The Hospital and Medical Facilities Amendments of 1964, Pub. L. 88-443, § 2, 78 Stat. 447, added new section 318 to the Public Health Service Act, 42 U. S. C. §§ 201 *et seq.*, which authorized expenditure of funds over the following five year period for grants to state agencies chosen in accordance with 42 U. S. C. § 291d(a)(1) to cover part of the costs of "projects for developing (and from time to time revising) and supervising and assisting in the carrying out of comprehensive regional, metropolitan area, or other local area plans for coordination of existing and planned health facilities, and facilities related thereto, and services provided by such facilities." *See generally* Comment, *Comprehensive Health Planning—Federal, State, Local: Concepts and Realities*, 1970 Wis. L. Rev. 838, 843-46.

service more than itself. A commercial laundry contacted was not interested in handling the full volume of laundry business of all the hospitals involved, and most of the other available commercial laundries were considered incapable of handling the heavy volume. The Council concluded that a shared non-profit, off-premises laundry would best accommodate the requirements of the member hospitals both from the viewpoint of quality of the service and economies of scale. Accordingly, HCSC-Laundry was formed.[3] Its laundry plant was built and equipped at a cost of approximately 2 million dollars, which it secured from local banks by using as collateral fifteen year contracts from 10 area hospitals. It employs approximately 125 people.

The corporation has no capital stock. Each participating hospital is a dues-paying member of the corporation. HCSC dues were $500 for the taxable year in issue. Centronia Ambulance Corps does not pay dues in order to receive laundry service. HCSC-Laundry's only income in addition to the dues is a laundry charge of 1½¢ per pound of laundry serviced which is charged to each customer over the actual cost. "Cost" for this purpose includes operating expenses, debt retirement, and linen replacement. This charge in excess of cost is placed in a fund for equipment replacement and acquisition.

HCSC-Laundry sought exemption from federal income tax and, on March 26, 1976, filed an Application for Recognition of Exemption (Internal Revenue Service Form 1023) under Section 501(c)(3) of the Internal Revenue Code. This section authorizes exemption for corporations "organized and operated exclusively for religious, charitable, scientific, or . . . educational purposes . . . no part of the net earnings of which inures to the benefit of

3. Taxpayer was originally named Hospital Central Services Corporation. Its name was changed in 1970.

any private shareholder or individual . . . ." I. R. C. § 501 (c)(3).[4] It is stipulated that plaintiff has never made a

4. Section 501 provides in pertinent part:

§ 501. Exemption from tax on corporations, certain trusts, etc.

(a) Exemption from taxation—An organization described in subsection (c) or (d) or section 401(a) shall be exempt from taxation under this subtitle unless such exemption is denied under section 502 or 503.

* * *

(c) List of exempt organizations—The following organizations are referred to in subsection (a):

* * *

(3) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

* * *

(e) Cooperative hospital, service organizations—For purposes of this title, an organization shall be treated as an organization organized and operated exclusively for charitable purposes, if—

(1) such organization is organized and operated solely—

(A) to perform, on a centralized basis, one or more of the following services which, if performed on its own behalf by a hospital which is an organization described in subsection (c)(3) and exempt from tax-

distribution of money or property nor have any net earnings inured to the benefit of any member or individual.

4. (Cont'd.)

ation under subsection (a), would constitute activities in exercising or performing the purpose or function constituting the basis for its exemption: data processing, purchasing, warehousing, billing and collection, food, clinical, industrial engineering, laboratory, printing, communications, record center, and personnel (including selection, testing, training, and education of personnel) services; and

(B) to perform such services solely for two or more hospitals each of which is—

(i) an organization described in subsection (c)(3) which is exempt from taxation under subsection (a),

(ii) a constituent part of an organization described in subsection (c)(3) which is exempt from taxation under subsection (a) and which, if organized and operated as a separate entity, would constitute an organization described in subsection (c)(3), or

(iii) owned and operated by the United States, a State, the District of Columbia, or a possession of the United States, or a political subdivision or an agency or instrumentality of any of the foregoing;

(2) such organization is organized and operated on a cooperative basis and allocates or pays, within 8½ months after the close of its taxable year, all net earnings to patrons on the basis of services performed for them; and

(3) if such organization has capital stock, all of such stock outstanding is owned by its patrons.

For purposes of this title, any organization which, by reason of the preceding sentence, is an organization described in subsection (c)(3) and exempt from taxation under subsection (a), shall be treated as a hospital and as an organization referred to in section 170(b)(1)(A)(iii).

The IRS denied the application stating:

> Section 501(e) of the Code provides for exemption from Federal income tax of certain hospital service organizations organized and operated solely to perform specified services for member hospitals. Section 501(e)(I)(a)[sic] of the Code lists the specified services as data processing, purchasing, warehousing, billing and collection, food, industrial engineering, laboratory, printing, communications, record center, and personnel (including selection, testing, training and education of personnel) services.
>
> Since laundry services are not one of the services specified in section 501(e)(I)(a)[sic], the organization does not meet the requirements of section 501(e) of the Code, and thus is not exempt from Federal income tax under Section 501(c)(3). See Rev. Rul. 69-160 C. B. 1969-I, 147. Also see Rev. Rul. 69-633.

On December 16, 1976, HCSC-Laundry filed a federal corporate income tax return (form 1120) for the fiscal year ending June 30, 1976 indicating taxable income of $123,521.00 on which a federal income tax of $10,395.00 was paid. Promptly thereafter, it filed a Claim for Refund for overpaid federal income tax in the full amount paid, asserting it was "a tax-exempt organization under sections 501(c)(3) and/or 501(e) of the Internal Revenue Code of 1954." Although the IRS has informally advised HCSC-Laundry that the claim for the refund of taxes will be rejected, it has not taken formal action on this claim. This suit seeking a refund of the taxes paid followed.

The district court, on the basis of stipulated facts, entered summary judgment for HCSC-Laundry. *HCSC-Laundry v. United States,* 473 F. Supp. 250 (E. D. Pa.

1979). It held that despite the omission of laundry services from those particular services for hospitals which are exempted under section 501(e) of the Code, HCSC-Laundry was entitled to exemption as an organization described in section 501(c)(3) of the Code. The court concluded:

> The purpose of § 501(e) was to enlarge the category of charitable organizations exempt under § 501(c)(3), not to modify or narrow § 501(c)(3). Thus, it is improper to consider the addition of § 501(e) as causing to be excluded from § 501(c)(3) any organization that would have been included in § 501(c)(3) but for § 501(e), even if such organization was explicitly excluded from § 501(e) itself.

Id. at 253.

The court also rejected the IRS assertion that HCSC-Laundry was not entitled to a charitable exemption because it was a "feeder" organization under section 502(a) of the Code. That section provides that:

> An organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt from taxation under section 501 on the ground that all of its profits are payable to one or more organizations exempt from taxation under section 501.

The court found that HCSC-Laundry was "a non-profit enterprise wholly controlled by charitable organizations 'in order to effect economies in their own operations'," 473 F. Supp. at 254, and determined that since HCSC-Laundry was an integral part of the hospitals, it was not a feeder organization under section 502(a) as clarified by the applicable Treasury Regulation on In-

come Tax, 26 C. F. R. § 1.502-1 (1979).[5] 473 F. Supp. at 254-55.[6] Therefore the court held HCSC-Laundry was

5. The relevant part of the regulation provides:

(b) If a subsidiary organization of a tax-exempt organization would itself be exempt on the ground that its activities are an integral part of the exempt activities of the parent organization, its exemption will not be lost because, as a matter of accounting between the two organizations, the subsidiary derives a profit from its dealings with its parent organization, for example, a subsidiary organization which is operated for the sole purpose of furnishing electric power used by its parent organization, a tax-exempt educational organization, in carrying on its educational activities. However, the subsidiary organization is not exempt from tax if it is operated for the primary purpose of carrying on a trade or business which would be an unrelated trade or business (that is, unrelated to exempt activities) if regularly carried on by the parent organization. For example, if a subsidiary organization is operated primarily for the purpose of furnishing electric power to consumers other than its parent organization (and the parent's tax-exempt subsidiary organizations), it is not exempt since such business would be an unrelated trade or business if regularly carried on by the parent organization. Similarly, if the organization is owned by several unrelated exempt organizations, and is operated for the purpose of furnishing electric power to each of them, it is not exempt since such business would be an unrelated trade or business if regularly carried on by any one of the tax-exempt organizations . . . .

26 C. F. R. § 1.502-1(b) (1979).

6. In a recent decision presenting a similar fact pattern where a Louisiana laundry service organization providing laundry service to four participating hospital members sought tax exemption, a divided Tax Court denied exemption on the ground that the organization was a feeder organization. Associated Hospital Services, Inc. v. Commissioner, 74 T. C. No. 17 (May 6, 1980). It reached that result by application of the "re-enactment doctrine" under which treasury regulations and interpretations which have continued over a long period of time without substantial change, and which apply to unamended or substantially reenacted statutes, are

exempt from taxation as an exempt organization under section 501(c)(3) of the Internal Revenue Code of 1954. *Id.* at 255.

III.

On appeal, the IRS argues that the legislative history indicates that section 501(e) is the exclusive method whereby a hospital service organization, such as HCSC-Laundry, is entitled to tax-exempt status. It asserts that the Congressional intent is clear that a hospital service organization performing laundry services is not entitled to tax exempt status. It is joined in this position by the Textile Rental Services Association of America and the International Fabricare Institute who have filed a brief amici curiae.

HCSC counters that the district court's construction holding it exempt is in accord with the applicable precedent. It contends that since the laundry performs on a joint basis the same hospital laundry activity which previously each of its members either performed individually as part of their tax-exempt activities or had performed for them by commercial laundries, the exemption should continue regardless of the form in which conducted, *i.e.*, jointly rather than separately.

IV.

It has been an accepted precept of statutory construction of tax laws, that a specific statute controls over a general one. *Bulova Watch Co. v. United States*, 365

6. (Cont'd.)

deemed to have received Congressional approval. See Helvering v. Winmill, 305 U. S. 79, 83 (1938). The Government has not appealed from the district court's disposition of this issue and it is therefore not before us.

U. S. 753, 758 (1961). In *Nitzberg v. Commissioner,* 580 F. 2d 357 (9th Cir. 1978), the appeal posed the problem of whether certain losses incurred in connection with the operation of gaming tables are to be treated as "ordinary and necessary expenses" deductible under I. R. C. § 162(a), or as "losses from wagering transactions", deductible only to the extent of gains from such transactions, under I. R. C. § 165(d). The court applied the foregoing precept and held the provision providing specifically for wagering losses governed. *See also State Mutual Life Assurance Co. v. Commissioner,* 246 F. 2d 319, 323 (1st Cir. 1957).

In the discussion of the application of this precept as an aspect of the *ejusdem generis* rule which appears in 1 J. Mertens, The Law of Federal Income Taxation § 3.16, at 34 (1974), it is noted that "this rule of ejusdem generis is not invariable and should not defeat the legislative intent deducible from the entire context." The statutory provisions at issue in this case would, under ordinary circumstances, warrant application of the rule of *ejusdem generis* since section 501(e) deals specifically with jointly operated hospital services. Therefore, unless the legislative history indicates a contrary legislative intent, section 501(e) should be considered controlling.

Before the 1969 amendments to the Internal Revenue Code which added section 501(e) to the statute, there was no provision of the Code specifically dealing with mutual entities establishd by tax exempt hospitals to supply them with certain services. The Internal Revenue Service took the position that if two or more tax exempt hospitals had joined together to create an entity to perform ordinary commercial services for them, the entity was not a tax exempt organization.[7]

7. See Rev. Rul. 54-305, 1954-2 C. B. 127.

In 1967 a Senate amendment would have treated organizations created by tax exempt hospitals to supply them with certain commercial services as charitable organizations. This amendment was not accepted by the House. H. R. Rep. No. 1030, 90th Cong., 1st Sess. 73 (1967). A House Report from the same session, directed to a bill which would have allowed Hill-Burton funds for cooperative hospital facilities regardless of their exempt status under the Internal Revenue Code, referred to the IRS interpretation that "an organization established by a number of other organizations to provide services or facilities for them, is not considered 'nonprofit,' even though the organizations for whom the services or facilities are provided are each non-profit." H. R. Rep. No. 538, 90th Cong., 1st Sess. 32 (1967).

The following year, Congress began work on the tax amendments which were to culminate in the enactment of section 501(e). The Senate proposed an amendment to the Tax Adjustment Bill of 1968 which would have treated as charitable organizations almost all entities established by tax exempt hospitals to provide commercial services, including laundry service. 114 Cong. Rec. 7516 (1968); 114 Cong. Rec. 8111-12 (1968). In the Conference Committee the House acceded only to a more limited scope for section 501(e). Under the version of 501(e) which emerged from the Conference Committee, certain specified service organizations were to be treated as "organized and operated exclusively for charitable purposes." Mutual laundry service organizations were not among the specified service organizations. However, the omission of laundry services was not inadvertent.

The Conference report specifically states:

> The new subsection does not grant tax-exempt status if the hospital service organization performs any

> services other than those specified in the new subsection (for example, laundry services), or performs any services for any person or organization other than a tax exempt hospital.

H. R. Rep. No. 1533, 90th Cong., 2d Sess. 43 (1968).[8] It is further of interest that the then Acting Commissioner of the Internal Revenue wrote to the then Chief of Staff of the Joint Committee on Internal Revenue setting forth his understanding that "the cooperative laundry service itself would not be tax exempt."[9]

Although subsequent legislative history may not be as persuasive as contemporaneous history in indicating a Congressional intent, in the case of the interpretation of section 501(e) it also serves to demonstrate that the general understanding of those most directly affected, the hospitals, was that cooperative hospital laundries were

---

8. This interpretation was referred to again in the Conference Committee print on the 1968 statute which specifically noted that:

> The conferees agreed to the Senate provision, but limited it to a joint enterprise which is organized and operated *solely* to perform one or more of the following services for hospitals: data processing, purchasing, warehousing, billing and collection, food, industrial engineering, laboratory, printing, communications, record center, and personnel. *Thus, an organization is not to qualify for exemption under this section if it performs any other services such as, for example, general laundry services* or performs any services for other than a tax-exempt hospital.

Committee of Conference on H. R. 15414, 90th Cong., 2d Sess., Revenue and Expenditure Control Act of 1968, Explanation of the Bill H. R. 15414, As Agreed to in Conference 20 (Comm. Print 1968) (emphasis added).

9. Letter from Lawrence N. Woodworth to James F. Dring (Feb. 10, 1969) *reprinted in* App. C to Brief for the Appellant at 58, adopted by letter from William H. Smith, Acting Commissioner, to Lawrence N. Woodworth (Feb. 16, 1969) *reprinted id.* at 62.

not entitled to obtain "charitable" status under the Code. Accordingly, in 1976 the American Hospital Association requested the Senate Finance Committee to extend tax exempt status to cooperative hospital organizations that performed laundry services. That statement included the following:

> Although not permitted under Section 501(e), central laundries to serve hospitals and other health care institutions are generally recognized as offering many benefits and advantages over individual hospital laundries, and over many commercial laundries that, if available at all, may not provide the type of quality of specialized service that hospitals require.

The statement continued:

> From the legislative history of Section 501(e) we understand that Congress intended to permit a comprehensive range of both administrative and clinical activities to be performed by 501(e) organizations, but to exclude laundry services.

Among the various recommendations made by the American Hospital Association was the following:

> That Section 501(e) of the Internal Revenue Code be amended to include "laundry services" among the activities cooperative hospitals services organizations may perform for their members.

Tax Reform Act of 1975: Hearings on H. R. 10612 Before the Sen. Comm. on Finance, 94th Cong., 2d Sess. 2771-72 (1976) (statement of the American Hospital Association proposal was opposed by the representatives of commercial laundries, who urged the Senate Finance Committee not to give special tax treatment to central laundries. *See*

Certain Committee Amendments to H. R. 10612: Hearings Before the Sen. Comm. on Finance, 94th Cong., 2d Sess. 200 (1976) (statement of John J. Contney, Executive Director, Linen Supply Association of America).

Although the Tax Reform Act of 1976, Pub. L. 94-455, 90 Stat. 1520, contained an amendment to section 501(e) which would have included laundry services within the services specified in section 501(e), and this amendment was endorsed by the Senate Finance Committee, it was deleted from the Tax Reform Act by action on the floor of the Senate. *See* 122 Cong. Rec. 25915 (1976).

Thus a review of the legislative history supports the Internal Revenue Service's position that the statute reflects an explicit manifestation of legislative judgment and purpose not to afford cooperative hospital laundries tax exempt status.

It may be that Congress was misguided in its failure to include laundry services among those services specified in 501(c). It may be that in these days of high energy costs and rapidly accelerating hospital costs, tax exemption for mutual laundry services would be in the public interest. But, as the appellee's brief points out, "intensive lobbying pressure by commercial laundries resulted in hospital laundry activities being excluded from those activities to which specific legislative relief was granted." Appellee's brief, p. 29. The result reflects the political process in operation. Requests for relief or for change must be directed to Congress.

The district court relied on the line of cases holding that a hospital laundry service organization could qualify as a charitable organization under section 501(c). *Northern California Central Services, Inc. v. United States,* 591 F. 2d 620 (Ct. Cl. 1979); *Community Hospital Services, Inc. v. United States,* 79-1 U. S. T. C. ¶ 9301 (E. D. Mich. 1979); *Metropolitan Detroit Area*

Hospital Services, Inc. v. United States, 445 F. Supp. 857 (E. D. Mich. 1978); *Hospital Central Services Association v. United States,* 77-2 U. S. T. C. ¶ 9601 (W. D. Wash. 1977); *United Hospital Services, Inc. v. United States,* 384 F. Supp. 776 (S. D. Ind. 1974).

In three of those cases, *Metropolitan Detroit Area Hospital Services, Community Hospital Services, Inc.,* and *Hospital Central Services Association,* the courts said they reached their decisions on the basis of the decision of the original case in that series, *United Hospital Services, Inc. v. United States, supra.* That case, in turn, found persuasive the reasoning in *Hospital Bureau of Standards and Supplies, Inc. v. United States,* 158 F. Supp. 560 (Ct. Cl. 1958). It is those two cases which should be considered.

In *Hospital Bureau,* plaintiff taxpayer was a New York corporation which purchased hospital supplies in bulk from suppliers on behalf of its 207 hospital members to whom the resulting savings accrued, and also maintained a research department and conducted technical analysis of supplies ordinarily used by its member institutions. It claimed exemption as a charitable organization for the calendar years 1952 and 1953. At the time of the decision there had been no discussion in Congress about enactment of a specific provision to provide tax exemption for hospital service organizations. The only issue before the court was whether the taxpayer could be considered a corporation "organized and operated exclusively for charitable purposes" under the predecessor provision to section 501(c). The Court of Claims held that it was entitled to be so considered. That decision provides little assistance to the statutory analysis we must now undertake when the statute contains the subsequently enacted provision directly applicable to hospital service organizations.

By the time of the decision in *United Hospital Services, Inc. v. United States,* the first case to consider the tax status of a hospital laundry service organization, the statute had been amended to include section 501(e). Nonetheless, the court held that the "case is completely analogous to *Hospital Bureau of Standards and Supplies.* . . ." 384 F. Supp. at 781. Although the court recognized that "Congress intentionally omitted ordinary, general and commercial laundry services from the blanket exemption granted to hospital cooperatives in Section 501(e)," *id.* at 780, it held the taxpayer could be considered a charitable organization under Section 501(c)(3) on its own merits. It is not clear whether the *United States Hospital Services* decision is dependent upon the fact that the taxpayer was incorporated and doing business some years before section 501(e) was adopted in 1968, a fact stressed by the court. Later cases have not limited the holding in that way. See *Metropolitan Detroit Area Hospital Services,* 445 F. Supp. at 860-61.

In the most recent decision on comparable facts, *Northern California Central Services, Inc. v. United States, supra,* the Court of Claims adhered to its prior decision in *Hospital Bureau.* After considering the effect of section 501(e), it concluded that the intent of Congress was not to narrow the class of organizations entitled to an exemption as a "charitable organization" but to broaden that class, "and that, as to laundry services, it left the law as it was." *Id.* at 624. As noted in our prior discussion, we believe the legislative history to show a contrary legislative intent than that found by the Court of Claims. We believe that it demonstrates that Congress recognized that hospital service organizations were not heretofore encompassed within section 501(c), or that their inclusion within that section was questionable. In order to clarify its position, Congress enacted section 501(e) to specify that cer-

tain types of hospital service organizations shall be considered as charitable organizations. If they had already been within section 501(c), the enactment of section 501(e) would have been a totally superfluous undertaking by Congress, an anomalous result which we cannot attribute to it.[10]

We are constrained to hold that section 501(e) specifies the types of hospital service organizations which are encompassed within the scope of section 501(c) as "charitable organizations," and that since HCSC-Laundry does not fall within section 501(e), it is not entitled to treatment as a tax exempt organization. For the foregoing reasons, we will reverse the judgment of the district court and remand for further proceedings not inconsistent with this opinion. Each side will bear its own costs.

---

10. The result of our decision will not necessarily be that plaintiff must hereafter pay income taxes. It may be possible to structure the arrangement with the hospitals in some way to avoid receipt of any net income. One possible approach was suggested by then Acting Commissioner of the Internal Revenue Service. See letter referred to in note 9 *supra*. We need not decide that issue now.

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 79-2286

HCSC-LAUNDRY

v.

UNITED STATES OF AMERICA,
Appellant

(D. C. Civil No. 78-1409)

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

Present: ROSENN and SLOVITER, *Circuit Judges* and
LAYTON, *District Judge**

JUDGMENT.

This cause came on to be heard on the record from the United States District Court for the Eastern District of Pennsylvania and was argued by counsel on February 21, 1980.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court, filed July 11, 1979, be, and the same is hereby reversed, and the cause is remanded for further proceed-

* Honorable Caleb R. Layton, III, United States District Judge for the District of Delaware, sitting by designation.

ings not inconsistent with the opinion of this Court. Each party shall bear its own costs.

ATTEST:
THOMAS F. QUINN,
Clerk.

Certified as a true copy and issued in lieu of a formal mandate on June 30, 1980.

Test: THOMAS F. QUINN
Clerk, United States Court of Appeals for the Third Circuit.

IN THE
UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

CIVIL ACTION NO. 78-1409

HCSC-LAUNDRY

v.

UNITED STATES OF AMERICA

MEMORANDUM AND ORDER.

TROUTMAN, *J.* JULY 10, 1979

Plaintiff Hospital Central Services, Inc. is claiming a refund for federal income taxes paid for plaintiff's fiscal year ending June 30, 1976, in the amount of $10,395.00. Plaintiff is a nonprofit corporation under the Pennsylvania law and its sole activity is providing laundry and linen services to fifteen member nonprofit hospitals in southeastern Pennsylvania and to a nonprofit volunteer ambulance service. The issue is whether plaintiff, in furnishing this service, is exempt from taxation under Section 501(a) of the Internal Revenue Code of 1954, 26 U. S. C. § 501(a) as an organization described in 26 U. S. C. § 501(c)(3).

Both sides have moved for summary judgment. The following facts have been stipulated. Plaintiff was incorporated in January 3, 1967, as a nonprofit corporation under the Pennsylvania Nonprofit Corporation Law, adopted May 5, 1933. (Stipulation of Facts, ¶ 1). Its principal office is located at 2171 28th Street, S. W. Allentown, Pennsylvania. (¶ 2). Plaintiff's purpose is set forth

in paragraph 4 of the A 'cles of Incorporation as amended May 29, 1970:

> "A. To operate and maintain a hospital laundry and linen supply program for those public hospitals and nonprofit hospitals or related health facilities organized and operated exclusively for religious, charitable, scientific, or educational purposes that contract with this corporation.
>
> B. To cooperate with the Greater Lehigh Valley Hospital and Health Planning Council in carrying out the foregoing purposes.
>
> C. To accomplish the foregoing purposes in a manner consistent with the provisions of Section 501 (c)(3) of the Internal Revenue Code of 1954." (¶ 1, Exhibit A.)

On March 26, 1976, plaintiff filed an Application for Recognition of Exemption (Internal Revenue Service Form 1023) seeking exemption from federal income tax under Section 501(c)(3) of the Internal Revenue Code. (¶ 4.) Under date of June 21, 1976, said application was rejected for the reason that "Since laundry services are not one of the services specified in Section 501(e)(I)(a), the organization does not meet the requirements of Section 501(e) of the Code, and thus is not exempt from Federal Income Tax under Section 501(c)(3). See Rev. Rul. 69-160 C. B. 1969-1, 147. Also see Rev. Rul. 69-663." (¶ 5.) Plaintiff filed its federal corporation income tax return (form 1120) for its fiscal year ended June 30, 1976, with the Internal Revenue Service Center at Philadelphia, Pennsylvania, on December 16, 1976. Said return indicated taxable income of $123,521.00 on which federal income tax of $10,395.00 was paid by plaintiff on December 16, 1976. (¶ 6.) On January 19, 1977, plaintiff filed

with the Internal Revenue Service a Claim for Refund for overpaid federal income tax for its fiscal year ended June 30, 1976, in the amount of $10,395.00. (¶ 7.) The Internal Revenue Service has informally advised plaintiff that this claim will be rejected but plaintiff has received no formal notice of claim disallowance.

Plaintiff provides laundry and linen services to fifteen nonprofit hospitals located in the Greater Lehigh Valley, Reading, Scranton and suburban Philadelphia, Pennsylvania, areas, and to the Cetronia Ambulance Corps serving the Village of Cetronia, Pennsylvania. All of the hospitals served and the ambulance corps have received federal income tax exemptions under Section 501(c)(3) of the Internal Revenue Code. (¶ 9.) In order to discharge its purposes, a hospital requires reliable and quality laundry and linen services. (§ 10.)

Other stipulations state that plaintiff constructed its plant to serve hospitals, some of which had in-plant facilities (¶ 19); that plaintiff meets sanitary and quality standards for hospital linens (¶ 21); the Lehigh Valley Hospital and Health Planning Council (the Council) concluded that plaintiff's shared approach to laundry service allows for more economical processing than in-plant processing (¶ 16) and the Council concluded that better quality service would be supplied in this fashion (¶ 25); all funds paid by member hospitals in excess of cost are placed in a fund for acquisition and replacement of equipment (¶ 27); plaintiff has never made a distribution of money or property nor have any net earnings inured to the benefit of any member or individual (§ 29).

The Government contends that plaintiff is not an exempt organization for two reasons. First, it is not a cooperative hospital service as defined in § 501(e), and because the Congress specifically intended to leave shared laundry service out of § 501(e), it follows that plaintiff is

also not exempt under § 501(c)(3).[1] The Government

1. § 501 provides in pertinent part:

§ 501. Exemption from tax on corporations, certain trusts, etc.

(a) Exemption from taxation.—An organization described in subsection (c) or (d) or section 401(a) shall be exempt from taxation under this subtitle unless such exemption is denied under section 502 or 503.

* * *

(c) List of exempt organizations.—The following organizations are referred to in subsection (a):

* * *

(3) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation (except as otherwise provided in subsection (h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

* * *

(e) Cooperative hospital, service organizations.—For purposes of their title, an organization shall be treated as an organization organized and operated exclusively for charitable purposes, if—

(1) such organization is organized and operated solely—

(A) to perform, on a centralized basis, one or more of the following services which, if performed on its own behalf by a hospital which is an organization

1. (Cont'd.)

described in subsection (c)(3) and exempt from taxation under subsection (a), would constitute activities in exercising or performing the purpose or function constituting the basis for its exemption: data processing, purchasing, warehousing, billing and collection, food, clinical, industrial engineering, laboratory, printing, communications, record center, and personnel (including selection, testing, training, and education of personnel) services; and

(B) to perform such services solely for two or more hospitals each of which is—

(i) an organization described in subsection (c)(3) which is exempt from taxation under subsection (a),

(ii) a constituent part of an organization described in subsection (c)(3) which is exempt from taxation under subsection (a) and which, if organized and operated as a separate entity, would constitute an organization described in subsection (c)(3), or

(iii) owned and operated by the United States, a State, the District of Columbia, or a possession of the United States, or a political subdivision or an agency or instrumentality of any of the foregoing;

(2) such organization is organized and operated on a cooperative basis and allocates or pays, within 8½ months after the close of its taxable year, all net earnings to patrons on the basis of services performed for them; and

(3) if such organization has capital stock, all of such stock outstanding is owned by its patrons.

For purposes of this title, any organization which, by reason of the preceding sentence, is an organization described in subsection (c)(3) and exempt from taxation under subsection (a), shall be treated as a hospital and as an organization referred to in section 170(b)(1)(A)(iii).

also contends that plaintiff is a feeder organization as defined in § 502(a) [2] and thus is not an exempt organization.

Both of these contentions have been rejected by every Court that has ever considered them. See *United Hospital Services, Inc. v. United States,* 384 F. Supp. 776 (D. Ind. 1974); *Metropolitan Detroit Area Hospital Services, Inc. v. United States,* 445 F. Supp. 857 (E. D. Mich. 1978); *Northern California Central Services, Inc. v. United States,* 43 AFTR 2d 79-543 (Ct. Claims, 1979); *Community Hospital Services, Inc. v. United States,* 43 AFTR 2d 79-931 (E. D. Mich. 1979); *Hospital Central Services Association v. United States,* 40 AFTR 2d 77-5642 (W. D. Wash. 1977).[3] While it is true that Congress did consider shared hospital services and expressly decline to include them in § 501(e)'s list of exempted activities, the courts have not held that such an exclusion had any application to the exemption of shared laundry service under § 501(c)(3). As Judge Dillin observed in the leading *United Hospital Services* case, the addition of § 501(e) to the Code did not exclude plaintiff in that case from consideration as a § 501(c)(3) charitable organization on its own merits. The purpose of § 501(e) was to enlarge the category of charitable organizations exempt under § 501(c)(3), not to modify or narrow § 501(c)(3). Thus, it is improper to consider the addition of § 501(e) as causing to be excluded

2. § 502(a) provides:

§ 502. Feeder organizations

(a) General rule.—An organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt from taxation under section 501 on the ground that all of its profits are payable to one or more organizations exempt from taxation under section 501.

3. There is no authority on this issue at this time from any of the Courts of Appeals of any of the Circuits, but appeals are currently pending in the Sixth and Ninth Circuits.

from § 501(c)(3) any organization that would have been included in § 501(c)(3) but for § 501(e), even if such organization was explicitly excluded from § 501(e) itself. "This latter section (§ 501(c)(3)) was not modified by the legislature in any way, and the legislation does not purport to take away charitable status from a corporation which had already acquired it. Insofar as this case is concerned, Section 501(e) is irrelevant". *United Hospital Services, Inc. v. United States, supra,* at p. 781.

Likewise, the Court of Claims, in considering this issue in *Northern California Central Services, Inc. v. United States, supra,* observed that it had held a cooperative hospital purchasing organization was exempt under § 501(c)(3) in *Hospital Bureau of Standards and Supplies v. United States,* 158 F. Supp. 560 (1958). During subsequent legislative sessions members of Congress referred to that decision as a "leading case" indicating that the Congress was well aware of the decision; no effort was made however, to alter the *Hospital Bureau of Standards'* interpretation of § 501(c)(3), or to limit its applicability to exclude shared laundry services, during the legislative considerations that led to passage of § 501(e), which provision did explicitly exclude shared laundry services from its—§ 501(e)'s—list of exempt service organizations. Thus, the *Hospital Bureau of Standards* interpretation of § 501(c)(3) remained intact, even though Congress wrote other law to take care of IRS decisions of which Congress disapproved.

There is no inherent contradiction in holding that shared laundry service may be exempt from tax under § 501(c)(3) even though such service was explicitly denied an exemption under § 501(e). In declining to include shared laundry service within the express exemption provisions of § 501(e) Congress was merely declining to become embroiled in a very sensitive issue. As the Court

of Claims noted, commercial laundries were vehemently opposed to such tax exemption, and faced with such a heated controversy, it appears that the Congress, deciding it was not at that time sufficiently informed to decide the issue, left such a matter to the courts, by leaving such services out of § 501(e), yet leaving § 501(c)(3) unaffected.

Having decided that the absence of an express § 501(e) exemption does not automatically bar exemption under § 501(c)(3), we must decide if exemption under § 501(c)(3) is proper. We conclude that plaintiff is a charitable organization. Membership in plaintiff's organization is limited to public or non-profit hospitals, which hospitals themselves are charitable organizations. Net earnings by plaintiff, in excess of costs and funds for necessary reserves, are allocated to member hospitals in proportion to respective quantity or value of business done with each member hospital for the year giving rise to such earnings. (Stipulation Exhibit A, By-Laws, Article XI, Section 1.) It is undisputable that a hospital cannot discharge its purposes without reliable and quality laundry and linen services, which service must meet standards particular to hospital situations. Therefore, plaintiff undisputedly performs an integral and necessary function of charitable organizations, and we conclude that plaintiff is a charitable organization. This conclusion is consistent with the unanimous decisions of the courts that have considered this issue. See *United Hospital Services, Inc. v. United States, supra; Metropolitan Detroit Area Hospital Services, Inc. v. United States, supra; Northern California Central Services, Inc. v. United States, supra; Community Hospital Services, Inc. v. United States, supra; Hospital Central Services Association v. United States, supra.*

The Government has also contended that plaintiff is a "feeder" organization, and is not entitled to a charitable

exemption because of the provisions of § 502(a). However, we conclude that that provision does not apply. That provision applies only to a profit-making enterprise which pays its profits to one or more charitable organizations. In this case, plaintiff is not a profit-making enterprise at all, but a non-profit enterprise wholly controlled by charitable organizations "in order to effect economies in their own operations". See *United Hospital Services, Inc. v. United States, supra,* at p. 782. Also, the applicable Treasury Regulation on Income Tax, 26 C. F. R. § 1.502-1, *Feeder Organizations,* provides as follows in pertinent part:

> "(b) If a subsidiary organization of a tax-exempt organization would itself be exempt on the ground that its activities are an integral part of the exempt activities of the parent organization, its exemption will not be lost because, as a matter of accounting between the two organizations, the subsidiary derives a profit from its dealings with its parent organization, for example, a subsidiary organization which is operated for the sole purpose of furnishing electric power used by its parent organization a tax-exempt educational organization, in carrying on its educational activities. However, the subsidiary organization is not exempt from tax if it is operated for the primary purpose of carrying on a trade or business which would be an unrelated trade or business (that is, unrelated to exempt activities) if regularly carried on by the parent organization. For example, if a subsidiary organization is operated primarily for the purpose of furnishing electric power to consumers other than its parent organization (and the parent's tax-exempt subsidiary organizations), it is not exempt since such business would be an unrelated trade or

> business if regularly carried on by the parent organization. Similarly, if the organization is owned by several unrelated exempt organizations, and is operated for the purpose of furnishing electric power to each of them, it is not exempt since such business would be an unrelated trade or business if regularly carried on by any one of the tax-exempt organizations.***"

In this case, the purpose of the plaintiff is an integral part of the exempt activities of the parent organization—laundry is an integral part of the functions of a hospital. Thus, we conclude that plaintiff is not a feeder organization and is, therefore, entitled to exemption.

In conclusion, we find that plaintiff is not barred from exemption because its activities were not expressly exempted from taxation under § 501(e), that plaintiff is an exempt organization under § 501(c)(3) and that the provisions of § 502(a) do not apply to plaintiff. Accordingly, we will grant plaintiff's motion for summary judgment, and deny defendant's motion for summary judgment. Our findings, conclusions and the result thus reached are consistent with the concern and the desires of the Government to curb rising hospital costs. A different result would directly affect such costs to the detriment of the elderly and others dependent upon continued hospital services.

IN THE
UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

CIVIL ACTION NO. 78-1409

HCSC-LAUNDRY

v.

UNITED STATES OF AMERICA

ORDER.

TROUTMAN, *J.*

AND NOW, this 10th day of July, 1979, IT IS ORDERED that plaintiff's motion for summary judgment is GRANTED and defendant's motion for summary judgment is DENIED.

E. MAC TROUTMAN

J.